

## Message Text

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CEA-01 AGRE-00 DOE-11 SOE-02 OES-07 EUR-12 CEQ-01  
PA-02 /131 W

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R 021242Z MAR 78  
FM AMEMBASSY NEW DELHI  
TO SECSTATE WASHDC 9904  
INFO AMEMBASSY COLOMBO  
AMEMBASSY DACCA  
AMEMBASSY ISLAMABAD  
AMEMBASSY KABUL  
AMEMBASSY KATHMANDU  
AMCONSUL BOMBAY  
AMCONSUL CALCUTTA  
AMCONSUL MADRAS

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E.O. 11652: N/A  
TAGS: EFIN, ECON, IN  
SUBJECT: 1978-79 CENTRAL GOVERNMENT BUDGET AND ANNUAL PLAN ESTIMATES  
  
REF: NEW DELHI 3191

1. SUMMARY. ON FEBRUARY 28, FINANCE MINISTER PATEL PRESENTED  
THE 1978 -79 CENTRAL GOVERNMENT BUDGET AND ANNUAL PLAN ESTIMATES  
TO THE LOK SABHA. GOVERNMENT EXPENDITURES ARE PROJECTED AT RS 184.2  
BILLION AND REVENUES AT RS 173.7 BILLION, LEAVING A DEFICIT OF RS 10.5

BILLION. ANNUAL PLAN SPENDING IS ESTIMATED AT RS 116.5 BILLION, UP  
17 PERCENT OVER 1977-78. EXPENDITURES FOR AGRICULTURE/ALLIED PROGRAMS  
AND INTEREST PAYMENTS HAVE THE BIGGEST PERCENTAGE RISE IN THE BUDGET,  
BUT MOST OF THE INCREASES ARE RELATIVELY MODEST. GROSS FOREIGN  
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ASSISTANCE IS EXPECTED TO BE RS 17.6 BILLION, UP 24 PERCENT OVER  
REVISED 1977-78 FIGURES. THE MOST IMPORTANT CHANGES IN THE TAX  
STRUCTURE INVOLVE HIGHER EXCISE DUTIES FOR A WIDE RANGE OF ITEMS,  
INCLUDING ELECTRICITY AND COAL, THAT WILL RESULT IN A RISE IN INPUT  
COSTS AND CONSUMER PRICES. THE SMALL SCALE SECTOR OBTAINS SEVERAL  
TAX CONCESSIONS. THERE ARE SEVERAL PROPOSALS TO STIMULATE INVESTMENT,  
INCLUDING THE REDUCTION IN CUSTOMS DUTY FROM 40 TO 25 PERCENT AD

VALOREM ON SPECIFIED ITEMS OF CAPITAL EQUIPMENT NOT INDIGENOUSLY PRODUCED, AND ELIMINATION OF THE TAX ON INTEREST EARNINGS OF COMMERCIAL BANKS THAT HAS RESULTED IN LOWER LENDING RATES, BUT THEY HAVE BEEN CRITICIZED AS BEING HALF-HEARTED. OUR PRELIMINARY REACTION IS THAT THE BUDGET AND ANNUAL PLAN DOCUMENTS DO NOT YET ADD UP TO A COHERENT ECONOMIC STRATEGY NOR DO THEY APPEAR TO PROVIDE SUFFICIENT STIMULUS TO THE ECONOMY. GREATER EMPHASIS HAS BEEN PLACED ON AGRICULTURE AND ALLIED PROGRAMS. WE SHALL BE PROVIDING FURTHER INFORMATION ANALYSIS AND REACTION IN SEPARATE MESSAGES ON THIS SUBJECT. END SUMMARY.

2. OVERALL BUDGET. AFTER REVIEWING THE STATE OF THE ECONOMY (REFTEL), PATEL PLUNGED INTO AN EXPLANATION OF THE 1978-79 CENTRAL GOVERNMENT BUDGET. TOTAL EXPENDITURES ARE PROJECTED AT RS 184.2 BILLION, UP 12.7 PERCENT OVER REVISED 1977-78 BUDGET FIGURES. REVENUES IN THE COMING FISCAL YEAR WILL INCREASE BY ABOUT THE SAME PERCENTAGE AND ARE ESTIMATED AT RS 173.7 BILLION. A 1978-79 CENTRAL GOVERNMENT DEFICIT OF RS 10.5 BILLION IS PROJECTED, COMPARED TO A REVISED 1977-78 DEFICIT OF RS 9.75 BILLION. THE FOLLOWING TABLE PRESENTS AN OVERVIEW OF THE CENTRAL GOVERNMENT BUDGET (ALL FIGURES IN RUPEES MILLION).

	1977-78 BUDGET	1977-78 REVISED	1978-79 BUDGET
EXPENDITURES	155,680	163,440	184,170

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REVENUE	(94,870)	(97,430)	(108,990)
CAPITAL	(60,810)	(66,010)	(75,180)
REVENUES	154,840	153,690	173,670
REVENUE	(95,420)	(97,780)	(107,820)
CAPITAL	(59,420)	(55,910)	(65,850)
DEFICIT	840	9,750	10,500

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3. EXPENDITURES. APPROXIMATELY 60 PERCENT OF 1978-79 CENTRAL GOVERNMENT EXPENDITURES WILL GO FOR DEVELOPMENT PRORAMS. THE BIGGEST PERCENTAGE INCREASE IN GOVERNMENT SPENDING IS FOR AGRICULTURE AND ALLIED SERVICES, UP 34 PERCENT OVER REVISED 1977-78 FIGURES AND 74 PERCENT OVER THE PLANNED 1977-78 BUDGET, BUT THIS CATEGORY WILL ACCOUNT FOR ONLY 6.6 PERCENT OF TOTAL 1978-79 SPENDING. INTEREST PAYMENTS (11 PERCENT OF THE BUDGET) ARE ALSO UP SUBSTANTIALLY

DEFENSE SPENDING IS PROJECTED TO INCREASE SLIGHTLY, BUT ITS SHARE OF TOTAL SPENDING IN 1978-79 WILL DROP FURTHER TO 16 PERCENT. ON THE OTHER HAND, SPENDING ON INDUSTRY AND MINERALS AND GENERAL ECONOMIC SERVICES, PARTICULARLY FOREIGN TRADE AND EXPORT PROMOTION EFFORTS, IS ESTIMATED TO BE LOWER (IN ABSOLUTE RUPEE TERMS) IN 1978-79.

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4. ANNUAL PLAN EXPENDITURES. TOTAL EXPENDITURES OF THE 1978-79 ANNUAL PLAN ARE ESTIMATED AT RS 116.5 BILLION, UP ABOUT 17 PERCENT FROM THE CURRENT ANNUAL PLAN OF RS 99.7 BILLION, CONTINUING SCHEMES IN THE COMING YEAR'S PLAN ABSORB ABOUT RS 104.7 BILLION, LEAVING LESS THAN RS 12 BILLION FOR NEW PROJECTS (80 PERCENT OF THEM IN AGRICULTURE/RURAL DEVELOPMENT). FOR THE FIRST TIME IN MANY YEARS PLANNED EXPENDITURES OF THE STATES AND UNION TERRITORIES (51 PERCENT OF THE TOTAL) WILL BE MORE THAN THE CENTRAL PLAN, REFLECTING A SHIFT IN EMPHASIS, TOWARD THE RURAL SECTOR WHERE STATES SPENDING IS PREDOMINANT AND THE GOI'S PROFESSED DESIRE FOR GREATER

ECONOMIC DECENTRALIZATION. OF THE TOTAL 1978-79 ANNUAL PLAN SPENDING RS 29.2 BILLION (25 PERCENT) HAS BEEN ALLOCATED TO AGRICULTURE AND ALLIED PROGRAMS, IRRIGATION AND FLOOD CONTROL. EXPENDITURES ON AGRICULTURE AND ALLIED PROGRAMS ARE PROJECTED TO BE ALMOST 39 PERCENT OVER 1977-78. RS 22 BILLION (ALMOST 19 PERCENT) IS FOR POWER DEVELOPMENT, AND THE GOI HOPES FOR AN ADDITIONAL 3,500 MW CAPACITY IN 1978-79. PATEL SAID THAT THE GOI PLANS FOR AN ADDITIONAL 3 MILLION HECTARES OF IRRIGATED LAND IN THE COMING YEAR, BUT THE INCREASE (13 PERCENT) IN PLANNED FUNDS FOR IRRIGATION IS QUITE SMALL. RELATIVELY SIGNIFICANT RISES IN PLANNED EXPENDITURE ARE PROJECTED FOR RURAL ELECTRIFICATION, DAIRY DEVELOPMENT, SMALL SCALE INDUSTRIES, AND RURAL ROADS, WATER SUPPLIES AND HEALTH.

5. REVENUES AND DEFICIT. THE 1977-78 FISCAL DEFICIT OF RS 9.75 BILLION WAS MUCH MORE THAN PROJECTED MAINLY BECAUSE OF UNANTICIPATED LOANS FROM THE CENTER TO THE STATES AND THE INABILITY OF THE GOI TO USE FX RESERVES TO IMPORT GOODS ON GOVERNMENT ACCOUNT. THE EVEN LARGER DEFICIT PROJECTED FOR THE COMING YEAR IS DUE TO THE HIGHER SPENDING NOTED ABOVE, DESPITE PATEL'S ATTEMPT TO FIND NEW REVENUES. HE HAS PROPOSED NEW TAXES AMOUNTING TO RS 5.5 BILLION, PRIMARILY IN CHANGED EXCISE DUTIES, WHICH IS THE MOST IMPORTANT CATEGORY OF CENTRAL GOVERNMENT REVENUES. OUTSTANDING DEBT OF THE GOI UNCLASSIFIED

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IS EXPECTED TO AMOUNT TO RS 253 BILLION AT END MARCH 1978 AND RS 294 BILLION AT END MARCH 1979.

6. EXTERNAL ASSISTANCE. FOR 1978-79 GROSS EXTERNAL ASSISTANCE, INCLUDING GRANTS AND SPECIAL CREDITS, IS PROJECTED AT RS 17.6 BILLION AND NET ASSISTANCE, 11.4 BILLION (UP 24 AND 45 PERCENT, RESPECTIVELY, FROM REVISED 1977-78 FIGURES). NET LOANS FROM THE WORLD BANK GROUP ARE ESTIMATED AT RS 3.9 BILLION (64 PERCENT OF TOTAL NET EXTERNAL LOAN ASSISTANCE). ACCORDING TO THE BUDGET, NET NEGATIVE AID FLOWS ARE EXPECTED FROM THE US, USSR, FRG, UK AND CANADA IN 1978-79.

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R 021242Z MAR 78  
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7. EXCISE TAXES. UNDER ITEM 68 OF THE CENTRAL EXCISE TARIFF THE RATE OF DUTY ON "ALL ARTICLES NOT ELSEWHERE SPECIFIED" WILL BE RAISED FROM TWO TO FIVE PERCENT AD VALOREM. ITEMS THAT WILL BE EXEMPTED FROM THIS EXCISE ARE PESTICIDES AND INSECTICIDES, SOME PHARMACEUTICALS

AND DRUG INTERMEDIATES, AND NEWSPAPERS AND PERIODICALS. A SPECIAL DUTY OF ONE-TWENTIETH OF BASIC EXCISE DUTIES IS BEING LEVIED ON ALL GOODS EXCEPT COAL, ELECTRICITY AND PRODUCTS UNDER ITEM 68. A DUTY OF 2 PAISE PER KILOWATT HOUR ON ELECTRICITY GENERATED WILL BE IMPOSED BUT THIS WILL NOT AFFECT FARMERS. EXCISE RATES OF RS 5 TO 10 PER MT WILL BE LEVIED ON COAL. ADDITIONAL TAXES HAVE BEEN PLACED ON ADVERTISING AND POSTAL SERVICES. VARIOUS EXCISE DUTIES HAVE BEEN REDUCED OR ELIMINATED, THE MOST IMPORTANT BEING FOR SMALL SCALE MANUFACTURING UNITS WITH ANNUAL SALES OF LESS THAN RS 1.5 MILLION, WHICH WILL NOT HAVE TO PAY EXCISE DUTY ON SALES UP TO UNCLASSIFIED

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RS 500,000 ON 69 ITEMS.

8. DIRECT TAXES. THE DIRECT TAXATION STRUCTURE HAS REMAINED PRACTICALLY UNCHANGED. RATES OF COMPULSORY DEPOSITS (AS PERCENTAGE OF INCOME) HAVE BEEN RAISED TO BETWEEN 4.5 AND 15 THE LATTER PERCENTAGE ON ANNUAL INCOMES OF OVER RS 70,000. LIBERALIZED TAX CONCESSIONS HAVE BEEN GIVEN FOR APPROVED LONG TERM SAVINGS IN LIFE INSURANCE AND SIMILAR FUNDS.

9. CUSTOMS DUTIES. CUSTOMS DUTIES ON SPECIFIED ITEMS OF CAPITAL EQUIPMENT NOT PRODUCED INDIGENOUSLY WILL BE REDUCED FROM EXISTING RATES (AROUND 40 PERCENT AD VALOREM) TO 25 PERCENT. THE IMPORT

DUTY ON POLYESTER FILAMENT YARN HAS BEEN INCREASED FROM 120 TO 200 PERCENT AD VALOREM TO PROTECT INDIAN INDUSTRY.

10. STATE TAXES. PATEL NOTED THAT THE STATES WERE RELUCTANT TO GIVE UP SALES TAXES, WHOSE REVENUES NOW AMOUNTED TO RS 25 BILLION. ON THE OTHER HAND, HE CALLED FOR THE ABOLITION OF OCTROL DUTY ON THE TRANSPORT OF GOODS (A MAJOR HINDRANCE TO INTER AND INTRA-STATE TRUCK TRAFFIC). HE SAID THE CENTER WOULD BE HOLDING DISCUSSIONS WITH STATE GOVERNMENTS TO ELMINATE THIS "OBNOXIOUS LEVY". (THIS WAS THE ONLY PROPOSAL BOTH SIDES OF THE LOK SABHA APPLAUDED.)

11. INVESTMENT STIMULUS. TAXPAYERS INVESTING IN EQUITY SHARES OF NEW INDUSTRIAL COMPANIES WILL BE ALLOWED A TAX DEDUCTION IN THE COMPUTATION OF TAXABLE INCOME OF 50 PERCENT OF THE AMOUNT INVESTED IN SUCH SHARES (UP TO RS 10,000) IN ORDER FOR NEW FIRMS TO ATTRACT CAPITAL. THE SEVEN PERCENT TAX ON BANK INTEREST EARNINGS HAS BEEN ABOLISHED. (THE RESERVE BANK OF INDIA HAS ANNOUNCED NEW COMMERCIAL BANK RATES EFFECTIVE MARCH 1, INCLUDING MAXIMUM SHORT TERM LENDING INTEREST RATES OF 15-16 PERCENT. THE RBI ALSO ANNOUNCED A STANDARD RATE OF 4.5 PERCENT FOR SAVING DEPOSIT ACCOUNTS, AND A CUT IN OTHER DEPOSIT RATES BY UP TO ONE PERCENT). THE BUDGET MESSAGE PROPOSED

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THE CREATION OF A CONSORTIUM OF BANKS AND FINANCIAL INSTITUTIONS FOR PROVIDING RUPEE FINANCE FOR IMPORTING CAPITAL GOODS BY THE PRIVATE SECTOR. SEVERAL TAX MEASURES HAVE ALSO BEEN INTRODUCED TO STIMULATE THE CONSTRUCTION OF HOUSES, PARTICULARLY FOR LOW AND MIDDLE INCOME GROUPS.

12. SALE OF GOLD. GOLD IS TO BE SOLD FROM GOI STOCKS IN AN ATTEMPT TO END GOLD SMUGGING (THE DOMESTIC PRICE OF GOLD HAS BEEN APPROXIMATELY ONE-THIRD HIGHER THAN THE INTERNATIONAL PRICE IN RECENT DAYS), TO REDUCE THE GOVERNMENT DEFICIT AND COUNTERACT INFLATIONARY PRESSURES. ( ACCORDING TO RBI GOVERNOR PATEL, THESE STOCKS ARE WORTH ABOUT RS 5 BILLION AT DOMESTIC GOLD PRICES, BUT RBI STOCKS OF GOLD THAT ARE PART OF OFFICIAL FX RESERVES WILL NOT BE AFFECTED). IN ADDITION, THE GOI WILL EITHER IMPORT GOLD OR SELL SOME OF ITS STOCK TO DOMESTIC JEWELERS AT INTERNATIONAL PRICES TO ENCOURAGE INDIAN EXPORTS OF GOLD JEWELRY. DETAILS OF BOTH SCHEMES WILL BE ANNOUNCED LATER.

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13. COMMENT. PATEL CLAIMED THAT THE BUDGET WAS A BOLD STEP FORWARD TO TAKE ADVANTAGE OF THE COUNTRY'S "EXCEPTIONALLY FAVORABLE" ECONOMIC SITUATION. OUR PRELIMINARY REACTION IS THAT THE CENTRAL GOVERNMENT BUDGET AND THE ANNUAL PLAN ESTIMATES FOR THE COMING YEAR STILL DO NOT ADD UP TO A COHERENT ECONOMIC STRATEGY BY THE JANATA LEADERSHIP. ALTHOUGH THERE WAS SOME SHIFT IN PRIORITIES TOWARD AGRICULTURE AND RURAL DEVELOPMENT, IT WAS NOT AS MUCH AS EXPECTED. RELATIVELY MODERATE SPENDING INCREASES ARE PROJECTED FOR BOTH THE BUDGET AND THE PLAN. PRIORITY SECTORS OF IRRIGATION AND POWER DO NOT HAVE A VERY SUBSTANTIAL FUNDING INCREASE IN THE 1978-79 ANNUAL PLAN. ASSUMING THE BUDGETARY EXPENDITURE TARGETS ARE MET, THE OVERALL BUDGETARY/DEFICIT POSITION OF THE CENTER IN THE COMING YEAR MAY NOT BE MUCH DIFFERENT FROM THE SITUATION PREVAILING IN 1977-78.

14. IT IS UNCLEAR HOW THE RELATIVELY LARGE GOVERNMENT DEFICIT WILL  
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AFFECT FUTURE INVESTMENT AND INFLATION. THE GOI IS EVIDENTLY HOPING THAT INCREASED SPENDING AND IMPORTS PLUS INVESTMENT INCENTIVES WILL LEAD TO HIGHER DOMESTIC DEMAND AND OUTPUT THAT WILL COUNTERACT ANY INFLATIONARY PRESSURES. THE INCREASES IN EXCISE TAXES WILL AFFECT A WIDE RANGE OF ESSENTIAL CONSUMER GOODS, ALTHOUGH THE FINANCE MINISTRY CALCULATES THAT THE OVERALL EFFECT ON THE PRICE LEVEL WILL BE LESS THAN ONE PERCENT. FURTHER, THE PROJECTION OF A DETERIORATING DEFICIT POSITION IS A REFLECTION OF THE GOVERNMENT'S

INABILITY TO MOBILIZE MORE ADEQUATELY DOMESTIC RESOURCES AND OBTAIN A HIGHER VALUE OF REVENUES. THERE HAS BEEN LITTLE RATIONALIZATION OF THE TAX STRUCTURE, PARTICULARLY INDIRECT TAXES. ALSO OF IMPORTANCE IS THE FAILURE OF THE GOI TO EXPAND THE NET OF THE DIRECT TAX SYSTEM BY INCLUDING WITHIN IT SUCH UNDERTAXED INDIVIDUALS AS WEALTHY FARMERS. THE POLITICAL OPPOSITION TO SUCH A MOVE WAS EVIDENTLY TOO GREAT. THE GOI IS MAKING AN ATTEMPT TO DRAW DOWN FX RESERVES BY MEANS OF HIGHER IMPORTS, BUT IT REMAINS TO BE SEEN WHETHER IT WILL SUCCEED. WE SHALL BE PROVIDING FURTHER ANALYSIS IN SEPARATE AIRGRAMS ON THE BUDGET AND PLAN.

15. INDIANS HAD VERY HIGH EXPECTATIONS (PROBABLY UNREALISTICALLY SO) THAT THE JANATA'S FIRST FULL BUDGET WOULD CARRY OUT PAST RHETORIC, SO THERE IS A GENERAL LET DOWN WITH THE DISCOVERY THAT THE BUDGET HAS MADE

RELATIVELY MODEST CHANGES. REACTION OF POLITICIANS HAS PREDICTABLY DIVIDED ALONG PARTISAN LINES, WITH THE OPPOSITION CLAIMING THAT THE PROPOSALS WILL HIT THE "COMMON MAN" HARD. PRELIMINARY COMMENTS FROM REPRESENTATIVES OF ORGANIZED BIG BUSINESS HAVE BEEN GENERALLY CRITICAL OR LUKEWARM AT BEST. THE SPOKESMEN OF THE INFLUENTIAL FICCI AND ASSOCHAM HAVE CRITICIZED THE INCREASED EXCISE DUTIES, PARTICULARLY ON COAL AND POWER, AS "INFLATIONARY IN CHARACTER

AND "WHOLLY UNJUSTIFIED" AT A TIME WHEN INDUSTRY WAS FACED WITH UNCLASSIFIED

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DEMAND-RECESSION. THE MEASURES TO STIMULATE INVESTMENT AND BRING DOWN INTEREST RATES HAVE BEEN DESCRIBED AS "HALF-HEARTED" AND THE JANATA GOVERNMENT'S OVERALL BUDGET HAS BEEN TERMED A CONTINUATION OF THE "OLD TRAIL OF HESTANCY". THE DISCONTINUATION OF EXPENSES ALLOWED FOR DEVELOPMENT OF EXPORT MARKETS HAS BEEN CRITICIZED AS A DAMPER ON INDIA'S EXPORT PROMOTION EFFORTS. ON THE OTHER HAND, THE GREATER EMPHASIS ON AGRICULTURE/RURAL DEVELOPMENT HAS BEEN WIDELY WELCOMED. SMALL SCALE INDUSTRIALISTS HAVE BEEN ENTHUSIASTIC ABOUT THE PROPOSED TAX BENEFITS. EDITORIAL COMMENT HAS BEEN MIXED, BUT MOST OF IT HAS BEEN DECIDEDLY NEGATIVE, JUDGING THAT THE PROPOSED BUDGET WAS NOT LIKELY TO LEAD TO HIGHER RATES OF GROWTH, OUTPUT AND INVESTMENT.  
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## Message Attributes

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